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DEPARTMENT OF HEALTH SERVICES
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September 20, 2005

TO: Each Supervisor

FROM: Thomas L. Garthwaite, MD
Director and Chief Medical Officer

SUBJECT: HEALTH DEPARTMENT BUDGET COMMITTEE OF THE WHOLE

This is to provide an update on the Department of Health Services' (DHS) fiscal outlook.

The attached schedules provide an update of the Department's Fiscal Outlook since the last Health Department Budget Committee of the Whole on June 20, 2005. There have been a number of changes in the Department's forecast since the last report, the most significant of which are the approval by the State Legislature of legislation to implement a major redesign of hospital payments under California's Medi-Cal program and the settlement of the two lawsuits filed against the County to prevent the closure/transfer of Rancho Los Amigos National Rehabilitation Center and decrease in inpatient beds at LAC+USC Medical Center. Both of these are discussed in greater detail below.

The Department's forecast ending year fund balance for Fiscal Year 2005-06 is \$204.5 million, an increase from the previously forecast balance of \$154.2 million. This increase reflects the estimated impact of Medi-Cal Hospital Financing Redesign on the Department's fiscal outlook. The first funding shortfall appears in Fiscal Year 2006-07 and is projected to be \$139.8 million; reduced from the previous estimate of \$197.7 million. The Department's forecast cumulative shortfall through Fiscal Year 2008-09 is now projected to be \$889.1 million. The attachments provide greater detail of the changes in the Department's fiscal forecast.

In previous reports, the Department has included a schedule of potential events that might have substantially altered the fiscal outlook for the worse. These issues have been resolved as a result of both the negotiation of the State's Medi-Cal Hospital Financing Redesign program and the settlement of the Rodde and Harris lawsuits.

Finally, the forecast assumes the realization of savings associated with Scenario III savings under the Department's 2002 system redesign proposal. The two major components of this

are the 16 percent efficiency savings targeted for King/Drew Medical Center, which total approximately \$100 million over the forecast period, and approximately \$60 million in savings associated with the restructuring of emergency and inpatient psychiatric services in DHS hospitals through Fiscal Year 2008-09. It is critical to the Department's fiscal outlook that these savings are achieved; if not, the deficit would increase by these amounts by Fiscal Year 2008-09.

Medi-Cal Redesign

As noted above, legislation to restructure the State's hospital payment system under the Medi-Cal program has been approved by the Legislature and is pending the Governor's signature. Assuming the elements of this new hospital financing mechanism work satisfactorily over the next four years, the estimated revenue impact of this restructuring on DHS finances will be \$383.9 million through Fiscal Year 2008-09. In Fiscal Year 2005-06, Medi-Cal Hospital Financing Redesign is estimated to result in an additional \$72.7 million in revenue to the Department.

Medi-Cal Hospital Financing Redesign is comprised of two major components. The first protects the aggregate baseline funding for public and private safety net hospitals during the five year waiver period, subject to adjustments to the baseline that begin occurring Fiscal Year 2006-07. The baselines represent actual Fiscal Year 2004-05 inpatient Medi-Cal revenues earned by safety net disproportionate share hospitals (DSH), including inpatient fee-for-service, DSH, SB 1255, and graduate medical education components. The Department estimates that the hold harmless funds equal \$786 million in Fiscal Year 2005-06, which is approximately \$17.7 million higher than reported in the June forecast.

The second component, known as stabilization funds, is growth funding allocated between public and private safety net hospitals on a 60/40 basis, respectively, during the first and second years of the waiver. Additionally, for the first year only, 70 percent of the public hospitals' portion of growth funding will be available to all public hospitals, and the remaining 30 percent will be distributed to those public hospitals, such as Los Angeles County, that are "donors" with respect to overall certified public expenditures. The Department estimates this will result in \$55 million in revenue in Fiscal Year 2005-06.

Medi-Cal Hospital Financing Redesign also creates new special funding of up to \$48 million annually for distressed Medi-Cal hospitals statewide, including those that do not presently participate in the DSH program. The distribution of these funds will be made by the California Medical Assistance Commission, the agency responsible for establishing Medi-Cal hospital reimbursement rates.

Finally, the legislation does not address the expansion of mandatory Medi-Cal managed care to cover aged, blind, and disabled Medi-Cal recipients, which has been postponed until next year. As a result, the State may lose up to \$180 million in revenue available under the federal waiver negotiated by the Schwarzenegger Administration in Fiscal Years 2005-06 and 2006-07, if certain milestones are not achieved. The State also is required to establish a new coverage program for adult indigent patients in the last three years of the waiver, as a

condition of receiving the \$180 million in funding in these years. It is unclear what the fiscal impact of such a shift in coverage for this population would be on the Department. Aged, blind, and disabled Medi-Cal beneficiaries constitute approximately 40 percent of DHS Medi-Cal patients. If this population were to enroll in managed care and seek care in non-County hospitals, the revenue implications could be significant.

While Medi-Cal Hospital Financing Redesign will have a positive impact on the Department's fiscal outlook, it does not ultimately solve anticipated funding shortfalls. As noted above, the Department is still forecasting a deficit of \$139.8 million beginning in Fiscal Year 2006-07 and growing to a cumulative deficit of \$889.1 million in Fiscal Year 2008-09.

Settlement of Rodde and Harris Lawsuits

The County recently settled two lawsuits related to the closure of inpatient beds at LAC+USC Medical Center and the closure/divestiture of Rancho Los Amigos National Rehabilitation Center (Ranch Los Amigos). The estimated impact of this settlement through Fiscal Year 2008-09 is a cost of \$276.4 million, which is \$61.4 million better than the previously forecast estimate of \$337.8 million if the Department was not able to take any action with regard to these facilities by Fiscal Year 2008-09.

The settlement maintains Rancho Los Amigos as a County-operated facility through Fiscal Year 2007-08, with a budgeted census that is reduced from 191 to 147. The estimated cost of maintaining this facility through the three year settlement is \$25.5 million.

With regard to LAC+USC Medical Center, the settlement ties the reduction in budgeted census to the establishment of expanded outpatient services and achievement of other operational efficiencies. The estimated net savings associated with these provisions of the settlement agreement are \$21.1 million through Fiscal Year 2008-09.

Other Changes

The forecast also includes other adjustments in retirement costs, increased revenue from the Vehicle License Fees, and updated revenue estimates for cost-based reimbursement and managed care.

Please let me know if you have any questions.

TLG:ak

Attachments

c: Chief Administrative Officer
County Counsel
Executive Officer, Board of Supervisors

COUNTY OF LOS ANGELES - DEPARTMENT OF HEALTH SERVICES
SUMMARY OF CHANGES IN THE DHS FISCAL OUTLOOK
 JUNE 10, 2005 THROUGH SEPTEMBER 2, 2005

		Fiscal Year / Columns / \$ In Millions					
		04-05 / (1)	05-06 / (2)	06-07 / (3)	07-08 / (4)	08-09 / (5)	Total / (8)
(1)	Revised Estimated Cumulative Year-End Fund Balance / (Shortfall) - June 10, 2005	\$ 404.0	\$ 154.2	\$ (197.7)	\$ (565.0)	\$ (954.7)	\$ (954.7)
(2)	Net Impact of Medi-Cal Redesign	\$ -	\$ 72.7	\$ 92.1	\$ 106.4	\$ 112.7	\$ 383.9
Net Impact of Harris/Rodde Settlement							
(3)	Cost of inability to close/divest Rancho beyond 06/30/06.	\$ -	\$ -	\$ (69.4)	\$ (76.9)	\$ (81.8)	\$ (228.1)
(4)	Cost of inability to reduce LAC+USC 100 beds beyond 06/30/06.	-	-	(34.1)	(36.5)	(39.1)	(109.7)
	Subtotal	\$ -	\$ -	\$ (103.5)	\$ (113.4)	\$ (120.9)	\$ (337.8)
(5)	Net impact of proposal to reduce LAC+USC's budgeted census through reduced average patient length of stay (6.5 to 6.0), including enablers and resulting savings.	-	(5.4)	(1.4)	8.7	19.2	21.1
(6)	Net impact of proposed Rancho takeover negotiations, oversight panel and review with plaintiffs, liver clinic monitoring and reducing Rancho's budgeted census from 191 to 147.	-	(0.4)	11.1	14.8	-	25.5
(7)	Net impact of operating Rancho for one-year post-settlement at a reduced census (147) in preparation for closure/divestiture on June 30, 2009.	-	-	-	-	17.0	17.0
(8)	Cost of plaintiff attorney fees (one-time).	-	(2.2)	-	-	-	(2.2)
	Subtotal - Net Impact of Harris/Rodde Settlement	\$ -	\$ (8.0)	\$ (93.8)	\$ (89.9)	\$ (84.7)	\$ (276.4)
Other Significant Changes							
(9)	CAO increase in retirement costs per the CAO-proposed Supplemental Budget for September 20, 2005 and extended through FY 08-09.	\$ -	\$ (12.3)	\$ (12.6)	\$ (12.9)	\$ (13.2)	\$ (51.0)
(10)	CAO increase Vehicle License Fee estimates for FY 04-05 and extended through FY 08-09 based on estimates received on August 11, 2005.	6.6	6.7	6.8	6.9	7.0	34.0
(11)	Update CBRC revenue estimates on August 9, 2005 to include audit results for the Coastal Area and the Southwest Area for FY 01-02 and extended through FY 08-09.	6.3 (C)	5.0	5.1	5.3	5.5	27.2
(12)	Update managed care revenue estimates per the CAO-proposed Supplemental Budget for September 20, 2005 and extended through FY 08-09.	-	(3.7)	(3.7)	(3.7)	(3.7)	(14.8)
(13)	Update pharmacy costs for FY 05-06 per the CAO-proposed Supplemental Budget for September 20, 2005 and extended through FY 08-09.	-	(3.0)	(3.3)	(3.7)	(4.1)	(14.1)
(14)	Update AB 915 revenue estimates for FY 04-05 on July 19, 2005 to reflect updated audit disallowance estimates per Programs and Audits and extended through FY 08-09.	(4.4) (D)	(1.1)	(1.1)	(1.1)	(1.1)	(8.8)
(15)	Adjust timing of DHS capital projects for FY 05-06 through FY 07-08 per estimates on September 2, 2005.	-	1.2	9.4	10.8	(21.4)	-
(16)	Adjust LAC+USC Transition/EMR costs per estimates received on August 31, 2005. (E)	1.1	-	7.1	(9.0)	0.8	-
(17)	Change in FY 04-05 per final experience / Other minor ongoing changes to the future years estimates.	(9.7)	(7.1)	1.6	0.5	0.3	(14.4)
(18)	Forecast improvement/(reduction) roll-forward	-	(0.1) (B)	50.3 (B)	57.9 (B)	67.5 (B)	-
(19)	Revised Estimated Cumulative Year-End Fund Balance / (Shortfall) - September 2, 2005 (A)	\$ 403.9	\$ 204.5	\$ (139.8)	\$ (497.5)	\$ (889.1)	\$ (889.1)

Notes

- (A) Does not include the impact of the medical school agreements which are currently being negotiated for LAC+USC, H/UCLA and OVMC. Assumes CBRC/FQHC will be extended for each year beyond FY 04-05. CBRC extension for LA County's outpatient and clinic care was included in the FY 05-06 Adopted State Budget. A Medi-Cal State Plan Amendment to extend the program is currently pending CMS approval.
- (B) These amounts represent the cumulative change in the forecast from the prior fiscal year. For example, the (\$0.1) million in FY 05-06 is \$403.9 million - \$404.0 million from FY 04-05.
- (C) FY 04-05 includes changes for FY's 01-02 through 04-05.
- (D) FY 04-05 includes changes for FY's 02-03 through 04-05.
- (E) Reflects the refinement of planned expenses by the facility, with input from their consultants, due to changes in system design, delays in purchasing equipment and a re-evaluation of available and evolving technologies.

Estimate of Medi-Cal Redesign of LAC-DHS

Recent legislation (SB 1100) will dramatically restructure inpatient Medi-Cal payments to the California's safety net DSH hospitals (SNDH) under the State's new 1115 waiver. According to a data analysis distributed by the State on 8/29/05, a total of \$433.2M of the new \$766M Safety Net Care Pool (SNCP) under the waiver will be required to meet "hold harmless" baselines of SNDHs in FY 05-06. These baselines are actual FY 04-05 inpatient Medi-Cal revenue levels earned by SNDHs, including fee-for-service, DSH, SB 1255 and GME components.

Further, the SNCP is diminished by \$180M annually unless the State meets specific managed care milestones in FY's 05-06 and 06-07 and establishes a new coverage program(s) in the last three years of the waiver. Since it is unclear as to whether the State will meet these requirements and, even if so, unclear as to the adverse impact on SNDHs workload of mandatory managed care enrollment of the aged, blind and disabled Medi-Cal eligibles (representing 40% of LAC-DHS' Medi-Cal patients), and the creation of a new coverage program(s), we have excluded the availability of the \$180M from our financial estimates at this time. Further, the value of the \$180M will likely be diminished in FYs 07-08 through 09-10, as the Waiver requires that these amounts, and all other SNCP funds be counted as \$1.75, for each dollar received, against hospital OBRA '93 DSH caps.

Based on the State's 8/29/05 analysis, after deducting the baseline and \$180M amounts, and applying the equity adjustments and formulas in SB 1100 to the residual SNCP amount, it is roughly estimated that LAC-DHS will receive about \$55M in "stabilization" funds beyond its "hold harmless" baseline in FY 05-06. This amount is contingent on a pending CMS interpretation of allowable CPEs, which will impact both DSH and non-DSH revenue levels.

Accordingly, we have adjusted the DHS Fiscal Outlook to reflect the total (\$841.0M) of the "hold harmless" baseline and "stabilization" funds for FY 05-06. The previous amount, adjusted for Harris/Rodde, was \$768.3M, per the last (June 20, 2005) Fiscal Outlook update to the Board. For future fiscal years, we have anticipated 3% growth in the Medi-Cal inpatient component, except for the undocumented alien component, which must be funded by DSH funds for both Medi-Cal eligibles and the uninsured. The statewide totals for DSH and the SNCP do not grow over the five-year waiver term. Similar to DSH, we have held constant SNCP funding which covers 50% of the allowable inpatient uninsured cost.

(Even though the post-equity adjustment, public-private sharing percentages of 60%/40% expire after two years and the public hospital 70% baseline/30% donor percentages expire after one year, these formulas are used to project amounts through all five years, since the probability of their continuance is likely as good as any alternatives.)

COUNTY OF LOS ANGELES - DEPARTMENT OF HEALTH SERVICES
FISCAL OUTLOOK - SEPTEMBER 2, 2005
(\$ IN MILLIONS BASED ON FY 04-05 SUPPLEMENTAL BUDGET RESOLUTION)

Line #	FISCAL YEARS / COLUMNS							TOTAL / (8)
	2002-03 / (1)	2003-04 / (2)	2004-05 / (3)	2005-06 / (4)	2006-07 / (5)	2007-08 / (6)	2008-09 / (7)	
1. Surplus/Deficit as of June 26, 2002		\$ (326.6)	\$ (549.2)	\$ (709.4)				
2. Scenario III Reductions / Use of Designation Funds	*(see note)	267.8	327.8	357.5				
3. Original Fiscal Stabilization Revenue Request to help fund Scenario III (Not Budgetary Shortfall by FY)	*(see note)	\$ (58.8)	\$ (221.4)	\$ (351.9)	\$ (387.3) ^(A)	\$ (423.7) ^(A)	\$ (461.8) ^(A)	\$ (1,904.9)
4. Actual / Forecast Update **	263.9	340.0	321.8	251.9 ^{(C) (M)}	136.8 ^(M)	155.9 ^{(J) (M)}	89.8 ^{(J) (M)}	
5. Actual / Forecast Surplus/(Shortfall) ^(F)	\$ 263.9	\$ 281.2	\$ 100.4	\$ (100.0) ^(K)	\$ (250.5) ^(K)	\$ (267.8) ^(K)	\$ (372.0) ^(K)	\$ (372.0)
6. Beginning Fiscal Year Fund Balance	121.0 ^(G)	353.1 ^(H)	452.8 ^(I)	553.2	453.2	202.7	-	-
7. Estimated Cumulative Year-End Fund Balance/(Shortfall) ^(F)	\$ 384.9	\$ 634.3	\$ 553.2	\$ 453.2	\$ 202.7	\$ (65.1)	\$ (372.0)	\$ (372.0)
8. Defer Rancho Closure/Divestiture per Harris/Rodde Settlement through FY 07-08 and for One-Year Post-Settlement.	\$ -	\$ (49.5)	\$ (53.9)	\$ (59.5)	\$ (69.4)	\$ (76.9)	\$ (81.8)	\$ (391.0)
9. Defer LAC+USC 100 Bed Reduction per Harris/Rodde Settlement through FY 08-09.	-	(16.1)	(29.8)	(31.9)	(34.1)	(36.5)	(39.1)	(187.5)
10. Net Impact of Harris/Rodde Proposal at LAC+USC ^(N)	-	-	-	(5.4)	(1.4)	8.7	19.2	21.1
11. Net Impact of Harris/Rodde Proposal at Rancho ^(O)	-	-	-	(0.4)	11.1	14.8	-	25.5
12. Net Impact of Operating Rancho for One-Year Post-Settlement ^(P)	-	-	-	-	-	-	17.0	17.0
13. Cost of Plaintiff Attorney Fees	-	-	-	(2.2)	-	-	-	(2.2)
14. Impact to Beginning Fiscal Year Fund Balance	-	-	(65.6)	(149.3)	(248.7)	(342.5)	(432.4)	N/A
15. Revised Estimated Cumulative Year-End Fund Balance/(Shortfall)	\$ 384.9	\$ 568.7	\$ 403.9	\$ 204.5	\$ (139.8)	\$ (497.5) ^(L)	\$ (889.1) ^(L)	\$ (889.1)
16. Use of Designation Funds - Decrease/(Increase)		\$ (183.8)	\$ 164.8	\$ 204.5	\$ -	\$ -	\$ -	

NOTES TO FISCAL OUTLOOK

- * The \$56.8 million of FY 02-03 service cuts are efficiencies already in the FY 02-03 budget base at this point in time and; therefore, doesn't appear on this schedule.
- ** Includes revenues previously shown separately (Measure B, SPCP/UPL Waiver, SB 855, and the Federal portion of the Outpatient Lawsuit Settlement).
- (A) These amounts are extrapolations from the original 90% Medicaid block grant request used to determine the fiscal stabilization revenues for the June 2002 DHS Strategic Plan, which only extended through FY 05-06.
- (C) Reflects release of the \$96.1M trust fund reserve.
- (F) **These amounts are potentially improved by the managed care supplement proposal currently being worked on with the State and Federal governments.**
- (G) Reflects a beginning fund balance of \$366.9M less the \$245.9M fund balance included in the FY 02-03 Supplemental Budget Resolution.
- (H) Reflects a beginning fund balance of \$384.9M less the \$31.8M fund balance included in the FY 03-04 Supplemental Budget Resolution.
- (I) Reflects a beginning fund balance of \$568.7M less the \$115.9M fund balance included in the FY 04-05 Supplemental Budget Resolution.
- (J) These estimates do not take into account the opening of the LAC+USC replacement facility in July 2007. Per LAC+USC, current financial projections for the new LAC+USC are still in progress.
- (K) Reflects an "unidentified budget surplus" of \$90.0M for FY's 05-06 through 08-09 added by the CAO.
- (L) The forecast annual operating shortfalls for FY's 07-08 and 08-09 are \$357.7M and \$391.6M, respectively.
- (M) Does not include the impact of the medical school agreements which are currently being negotiated for LAC+USC, H/UCLA and OVMC. Assumes CBRC/FQHC will be extended for each year beyond FY 04-05. CBRC extension for LA County's outpatient and clinic care was included in the FY 05-06 Adopted State Budget. A Medi-Cal State Plan Amendment to extend the program currently pending CMS approval.
- (N) Per Harris/Rodde settlement proposal, census will be reduced through a reduced average patient length of stay (6.5 to 6.0); includes enablers and resulting savings.
- (O) Per Harris/Rodde settlement proposal, includes Rancho takeover negotiations, oversight panel and review with plaintiffs, liver clinic monitoring and reducing Rancho's budgeted census from 191 to 147.
- (P) Reflects savings from operating Rancho at a reduced census (147) for one-year post-settlement in preparation for closure/divestiture on June 30, 2009.